

Options Trading

Lesson 3

Individual Directional Trades

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Topics for this Lesson:

Individual Options trading

Usage criteria

Entry setup and criteria

Exit or Adjust ?

Morphing standalones

The Call option and The Put option:

- How are they displayed and what do the typical columns mean?

Below is a look at an option “chain” as shown on the ThinkorSwim platform

AMZN	AMAZON COM INC COM	1843.06	-1.01 -0.05%	B: 1842.56 A: 1843.00	NASDAQ	Company Profile
Underlying						
Trade Grid						
Option Chain						
Filter: Off Spread: Single Layout: Volume, Open Interest						
CALLS						
Strikes: 14						
PUTS						
Volume	Open.Int	Bid X	Ask X	Exp	Strike	Bid X Ask X Volume Open.Int
18 APR 19	(4)	100				20.03% (±33.656)
102	266	24.80 N	26.10 N	18 APR 19	1827.5	9.10 Z 9.35 Z 138 85
709	779	23.20 N	24.25 P	18 APR 19	1830	9.80 N 10.20 Z 584 550
169	211	21.60 N	22.55 Q	18 APR 19	1832.5	10.45 N 11.10 H 159 155
288	340	20.05 N	21.10 Z	18 APR 19	1835	11.55 M 12.15 N 426 229
167	106	18.65 N	19.65 N	18 APR 19	1837.5	12.40 N 13.10 H 303 140
1,631	1,236	17.20 N	18.10 Z	18 APR 19	1840	13.55 Z 14.30 N 1,225 604
432	223	15.95 N	16.65 Q	18 APR 19	1842.5	14.80 P 15.50 N 359 131
1,830	800	14.65 N	15.35 M	18 APR 19	1845	15.85 N 16.70 N 800 314
1,186	361	13.50 N	13.90 Z	18 APR 19	1847.5	17.10 N 18.05 N 495 159
4,187	2,176	12.35 N	12.95 X	18 APR 19	1850	18.55 Z 19.45 N 1,494 958
257	153	11.30 N	12.10 X	18 APR 19	1852.5	20.05 Q 20.80 N 77 68
471	540	10.25 N	10.85 X	18 APR 19	1855	21.35 N 22.35 N 186 86
93	47	9.35 N	10.00 N	18 APR 19	1857.5	22.85 N 23.95 N 38 37
827	1,011	8.50 N	8.80 P	18 APR 19	1860	24.45 N 25.60 N 198 211
26 APR 19 (12) 100 (Weeklys) 36.99% (±101.882)						
3 MAY 19 (19) 100 (Weeklys) 33.88% (±116.174)						
10 MAY 19 (26) 100 (Weeklys) 31.77% (±126.822)						
17 MAY 19 (33) 100 30.48% (±136.715)						

- The Long Call
- The Short Call
- The Long Put
- The Short Put

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Entering trades and their Nomenclature



"Buy to open" November 16.00 long call at the "ask" price



"Sell to close" November 16.00 long call at the "bid" price

Long Call Options

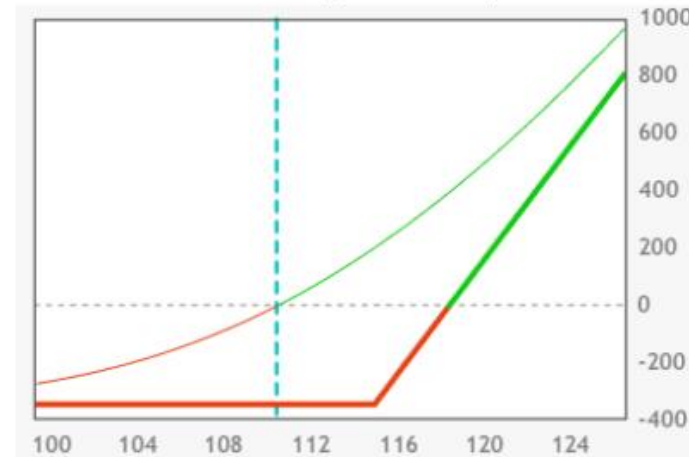
- Action
 - “Buy to Open (BTO)”
 - “Sell to Close (STC)”
- Rights
 - 1) Exercise the call to buy the equity at the strike price
 - 2) Resell the option to close it
 - 3) Allow the option to expire
- Expectation
 - Very bullish trend
- Basic Application
 - At the money (ATM) or slightly out of the money (OTM)
 - ~45 days in time value
 - Time decay works against this trade
- Type
 - This is considered a “Debit Trade”

Risk and Reward

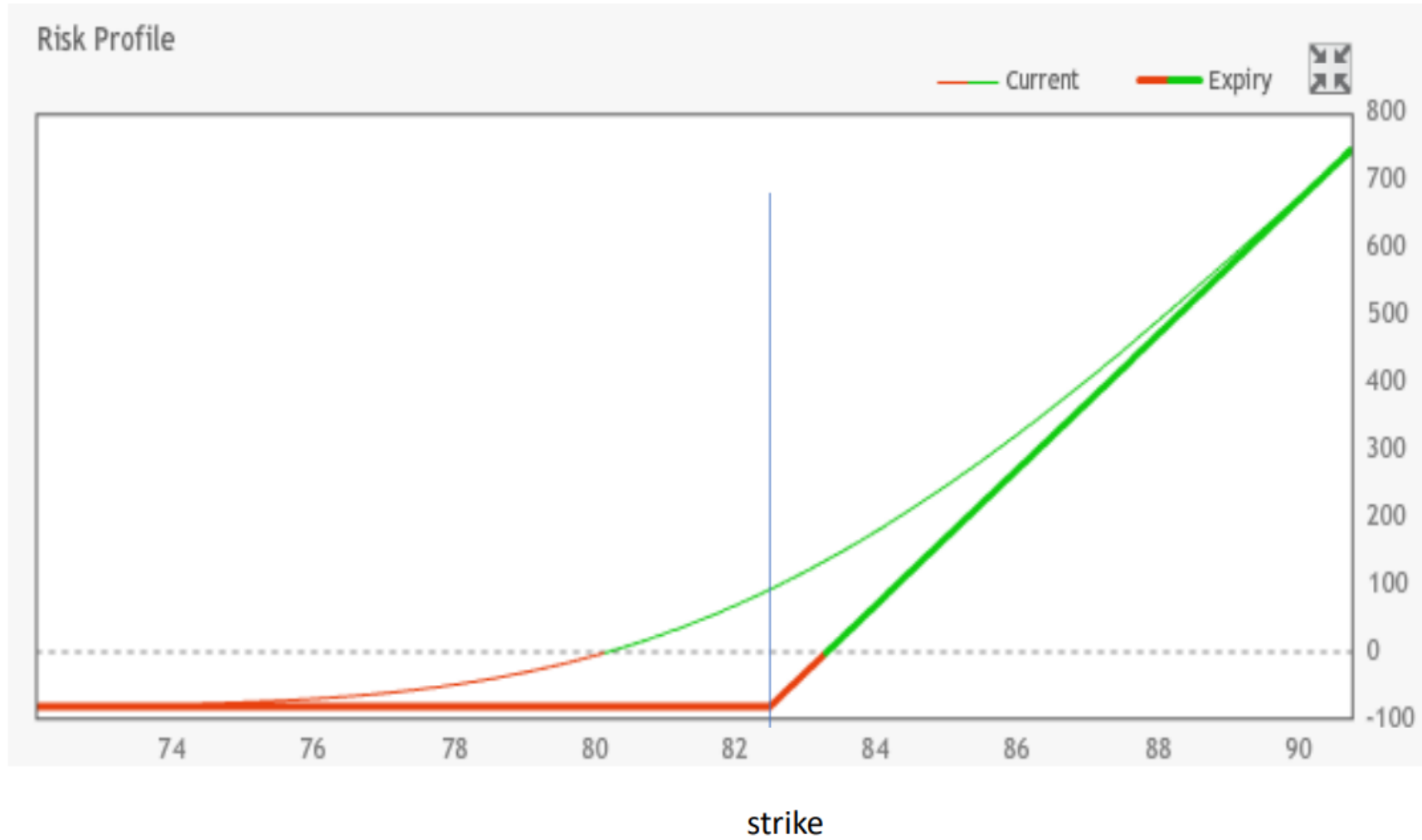
- Risk: Debit
- Reward: Theoretically unlimited
- Breakeven: Strike level + Debit paid

Exit Points

- Planned Exit (PE):
 - Percent net gain (e.g., 20%)
 - Exercise results in stock ownership
- Secondary Exit (SE):
 - Close at loss (e.g., 50%)
 - Adjust to a Spread Trade



Long Call

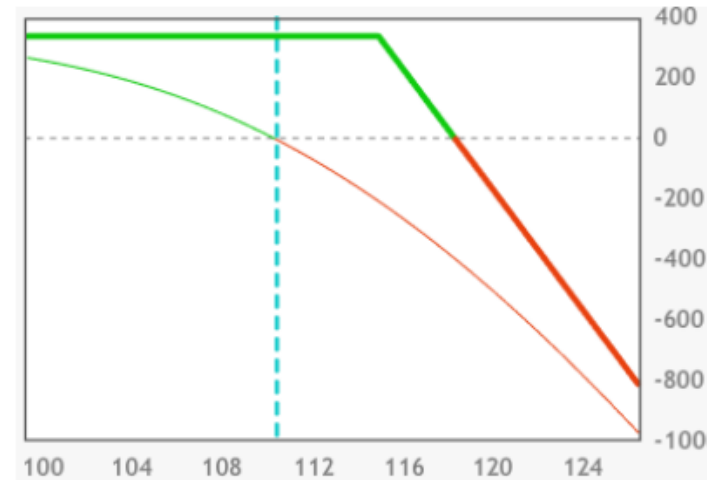


Short Call Options

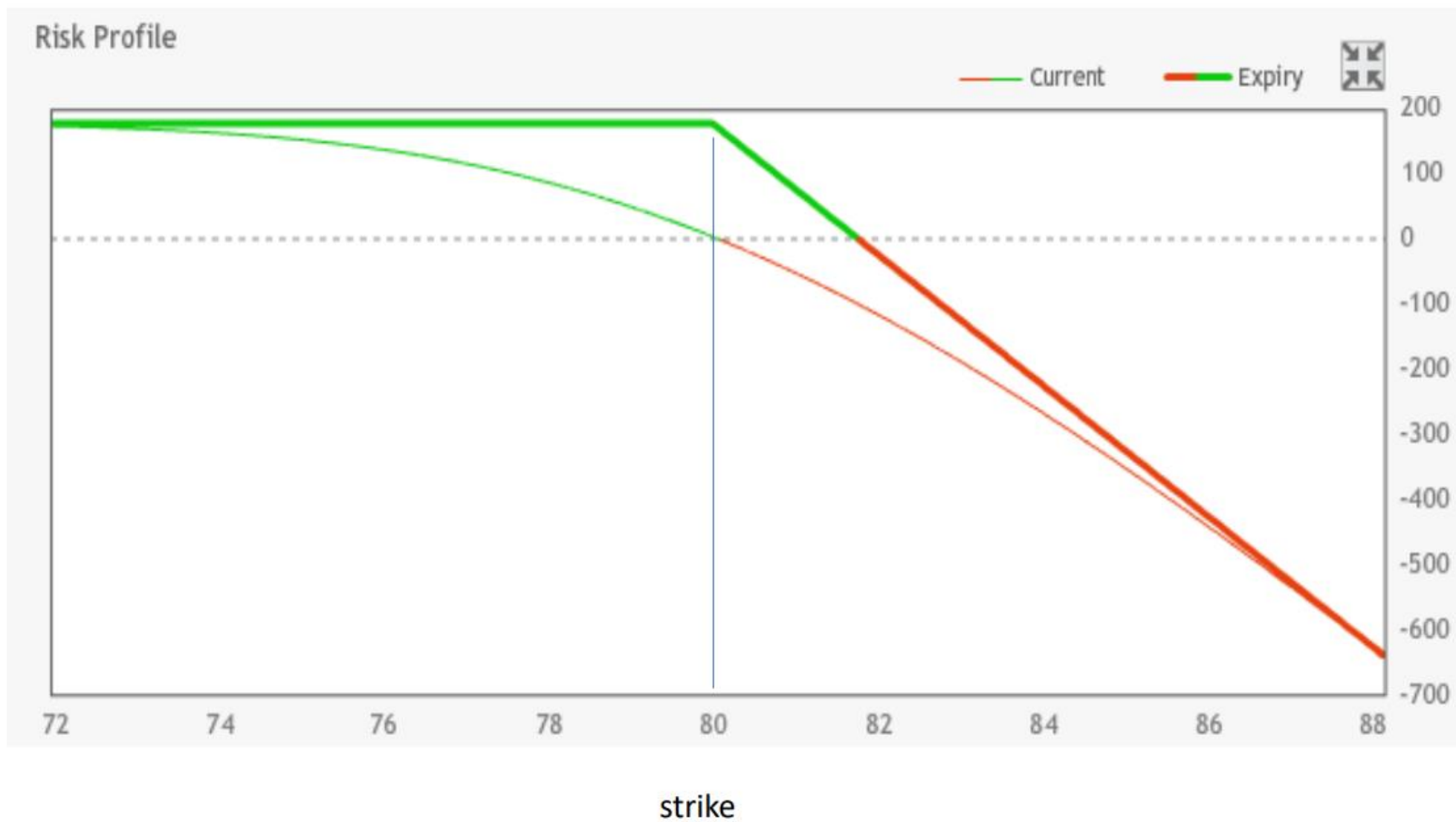
- Action
 - “Sell to Open (STO)”
 - “Buy to Close (BTC)”
- Obligation
 - If assigned: sell the equity at the strike price
- Expectation
 - Stagnant to bearish trend
- Basic Application
 - Out of the money (OTM)
 - Less than 30 days
 - Time decay helps this trade

NOTE: This trade represents unlimited risk. A long call or stock should accompany a short call to avoid unlimited risk.
- Type
 - This is considered a “Credit Trade”

- Risk and Reward
 - Risk: Theoretically unlimited
 - Reward: Credit
 - Breakeven: Strike level + Credit received
- Exit Points
 - Planned Exit (PE):
 - Let option expire OTM
 - Assignment results in short stock
 - Secondary Exit (SE):
 - Close at theoretical break-even
 - Adjust to a Spread Trade



Short Call



Long Put Options

- Action

- “Buy to Open (BTO)”
- “Sell to Close (STC)”

- Rights

- 1) Exercise the put to sell the equity at strike price
- 2) Resell the option to close it
- 3) Allow option to expire

- Expectation

- Very bearish trend

- Basic Application

- At the money (ATM) or slightly out of the money (OTM)
- At least 45 days in time value
- Time decay works against the trade

- Type

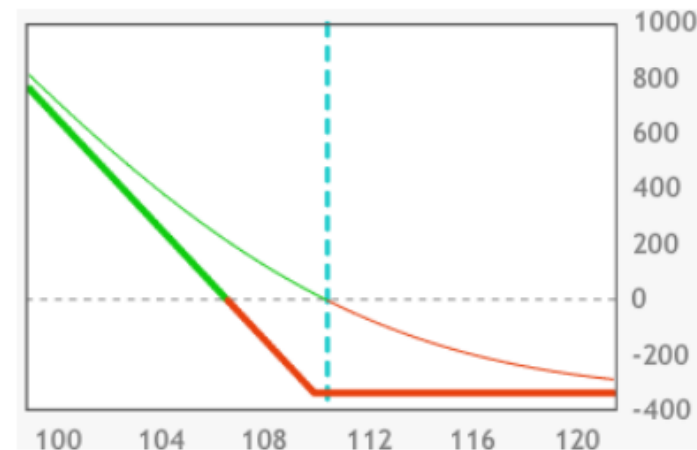
- This is considered a “Debit Trade”

- Risk and Reward

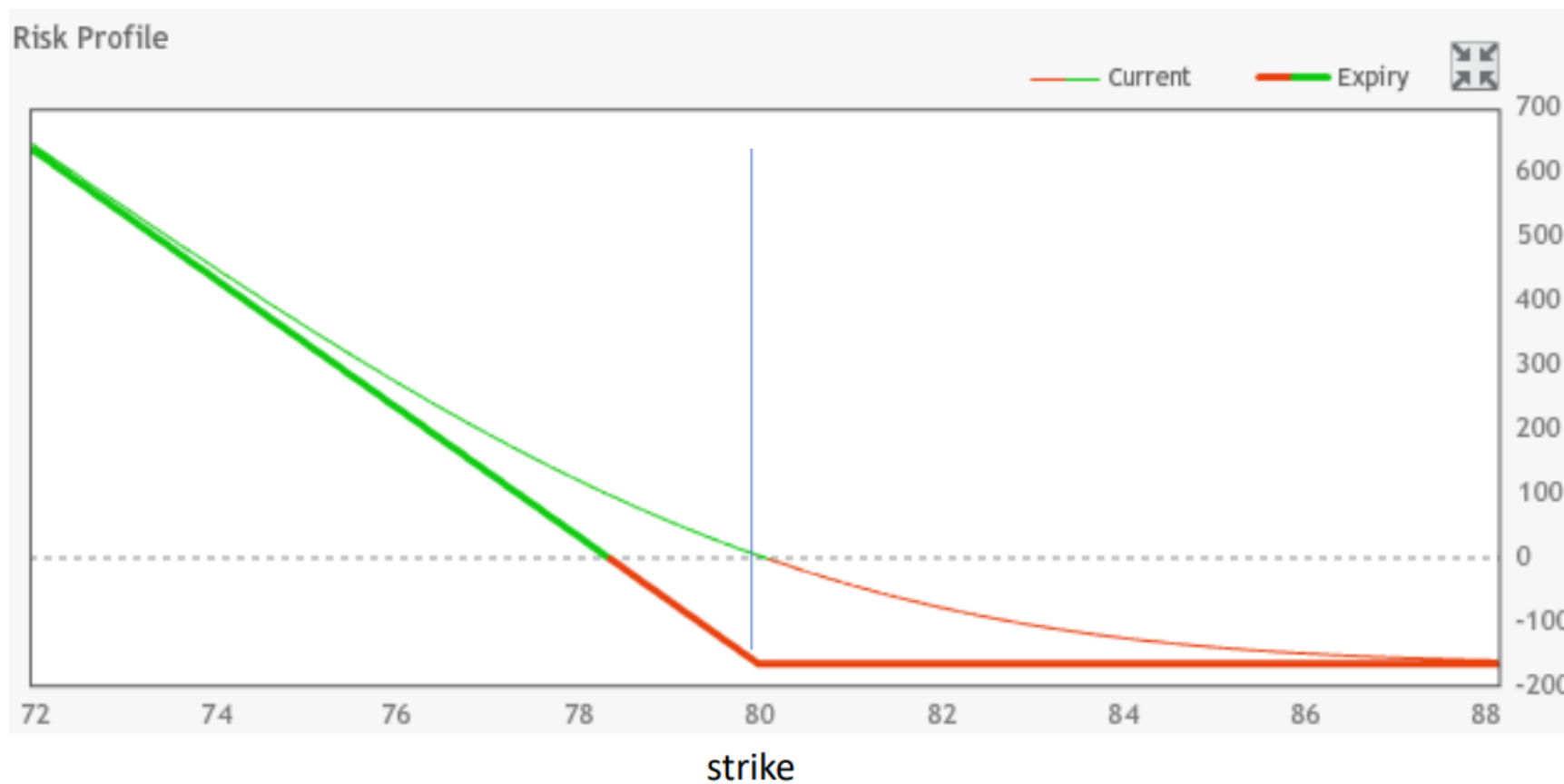
- Risk: Debit
- Max Reward: Strike level – Debit paid
- Breakeven: Strike level – Debit paid

- Exit Points

- Planned Exit (PE):
 - Percent net gain (e.g., 20%)
 - Exercise results in short stock
- Secondary Exit (SE):
 - Close at loss (e.g., 50%)
 - Adjust to a Spread Trade



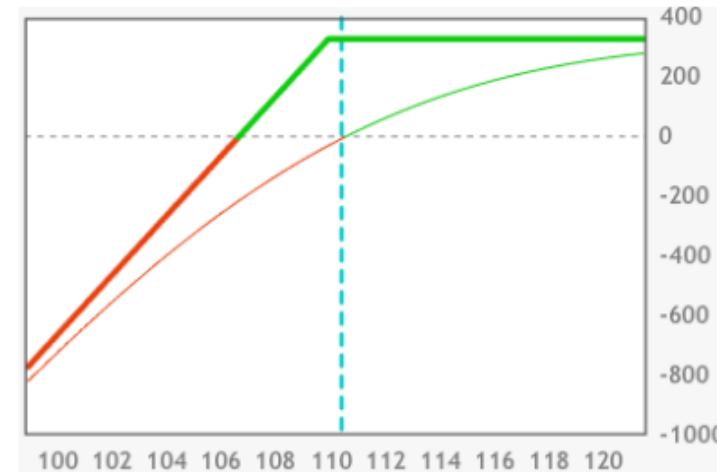
Long Put



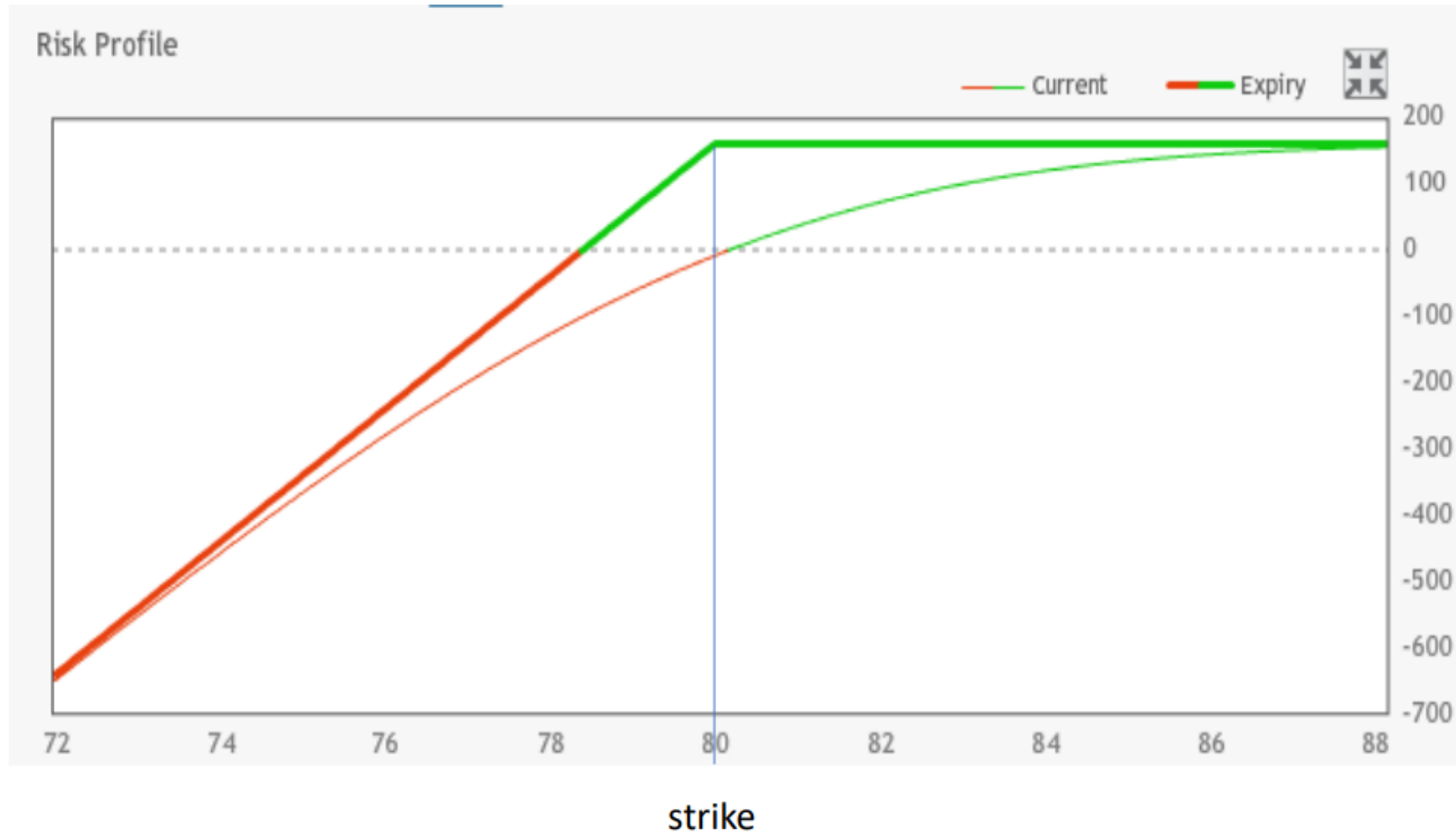
Short Put Options

- Action
 - “Sell to Open (STO)”
 - “Buy to Close (BTC)”
- Obligation
 - If assigned: buy the equity at the strike price
- Expectation
 - Stagnant to bullish trend
- Basic Application
 - Out of the money (OTM)
 - Less than 30 days
 - Time decay helps this trade
- Type
 - This is considered a “Credit Trade”

- Risk and Reward
 - Risk: Strike – Credit
 - Reward: Credit
 - Breakeven: Strike level – Credit received
- Exit Points
 - Planned Exit (PE):
 - Let option expire OTM
 - Assignment results in long stock
 - Secondary Exit (SE):
 - Close at a theoretical breakeven
 - Adjust to a Spread Trade



Short Put



GREEKS MATTER

<ul style="list-style-type: none">• Long Call• Delta: Positive 0 to +1• Gamma: Positive• Theta: Negative• Vega: Positive• Rho: Positive	<ul style="list-style-type: none">• Short Call• Delta: Negative 0 to -1• Gamma: Negative• Theta: Positive• Vega: Negative• Rho: Negative
<p>Long Put</p> <p>Delta: Negative -1 to 0</p> <p>Gamma: Positive</p> <p>Theta: Negative</p> <p>Vega: Positive</p> <p>Rho: Negative</p>	<p>Short Put</p> <p>Delta: Positive +1 to 0</p> <p>Gamma: Negative</p> <p>Theta: Positive</p> <p>Vega: Negative</p> <p>Rho: Positive</p>

Morphing standalones:

Where can we go from here ?

- Adjusting the single option
- Examples

Long Call : Where can we go from here ?

DEBIT TRADES

The Bull Call (call vertical)

- Long call (Existing Instrument)
 - Adding a Short call (reduces cost basis)
 - Still optimizes a bullish trend

The Call Calendar / Diagonal (call spread)

- Long call (Existing Instrument)
 - Typically long-term long call with 3 months or more of time
 - Adding a Short call (reduces cost basis) in a nearer expiration
 - Calendar has same strike
 - Diagonal typical short strike above long
 - Still optimizes a bullish trend

The maximum risk is the net debit of the trade

Long Call : Where can we go from here ?

CREDIT TRADES

The Bear Call (call spread)

- Long call (Existing Instrument)
 - Adding a Short call BELOW long strike
 - Optimizes a stagnant to bearish trend

The maximum risk is the strike differential minus the credit

Long Put : Where can we go from here ?

DEBIT TRADES

The Bear Put (put vertical)

- Long put (Existing Instrument)
 - Adding a Short put (reduces cost basis)
 - Short strike below long put strike
 - Still optimizes a bearish trend

The Put Calendar / Diagonal (put spread)

- Long put (Existing Instrument)
 - Typically long-term long put with 3 months or more of time
 - Adding a Short put (reduces cost basis) in a nearer expiration
 - Calendar has the same strike
 - Diagonal typically short strike below long
 - Still optimizes a bearish trend

The maximum risk is the net debit of the trade

Long Put : Where can we go from here ?

CREDIT TRADES

The Bull Put(put spread)

- Long put (Existing Instrument)
 - Adding a Short put ABOVE long strike
 - Optimizes a stagnant to bullish trend

The maximum risk is the strike differential minus the credit